

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name City of Ann Arbor Employees Retirement Sys	County Washtenaw
Fiscal Year End 6/30/07	Opinion Date December 20, 2007	Date Audit Report Submitted to State December 21, 2007	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

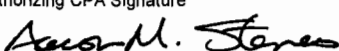
We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe) None	<input checked="" type="checkbox"/>	N/A	
Certified Public Accountant (Firm Name) Abraham & Gaffney, P.C.		Telephone Number 517-351-6836	
Street Address 3511 Coolidge Road, Suite 100		City East Lansing	State MI
		Zip 48823	
Authorizing CPA Signature 		Printed Name Aaron M. Stevens, CPA	License Number 1101024055

**CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM**

FINANCIAL STATEMENTS

Fiscal Years Ended June 30, 2007 and 2006



Issued by: Retirement System, 301 E. Liberty Street, Suite 680, Ann Arbor, Michigan 48104
(734) 994-4590

City of Ann Arbor
Employees' Retirement System

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Audit Committee
City of Ann Arbor Employees' Retirement System
Ann Arbor, Michigan

We have audited the accompanying statement of plan net assets of the City of Ann Arbor Employees' Retirement System as of June 30, 2007 and 2006, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the City of Ann Arbor Employees' Retirement System and do not purport to, and do not present fairly the financial position of the City of Ann Arbor, Michigan, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the City of Ann Arbor Employees' Retirement System as of June 30, 2007 and 2006, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and historical pension information, as identified in the Table of Contents, are not required parts of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

December 20, 2007

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2007 and 2006

The following is a discussion and analysis of the financial performance and position of the City of Ann Arbor Employees' Retirement System's (CAAERS). It is intended to provide an overview of CAAERS' financial activities for the fiscal years ended June 30, 2007 and 2006. This analysis should be read in conjunction with the *Independent Auditors Report* and with the financial statements, which follows this section.

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the financial statements, and (3) required supplementary information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Year Ended June 30,	
	<u>2007</u>	<u>2006</u>
Total assets	\$ 452,697,974	\$ 405,621,967
Total liabilities	<u>2,782,282</u>	<u>2,351,195</u>
Assets held in trust for pension benefits	<u>\$ 449,915,692</u>	<u>\$ 403,270,772</u>
Net investment income	\$ 65,009,274	\$ 40,089,656
Contributions:		
Plan members	2,653,369	2,951,544
Employer	<u>5,103,346</u>	<u>2,897,639</u>
Total contributions	<u>7,756,715</u>	<u>5,849,183</u>
Retiree pension benefits	24,505,435	22,567,344
Refunds of member contributions	<u>1,023,624</u>	<u>611,444</u>
Total benefits paid	<u>25,529,059</u>	<u>23,178,788</u>
Benefits paid in excess of contributions	17,772,344	17,329,605
General and administrative expenses	<u>592,011</u>	<u>7,508,880</u>
Net increase in net assets held in trust	<u>\$ 46,644,919</u>	<u>\$ 15,251,171</u>
Ratio of benefits paid to contributions	329%	396%

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2007 and 2006

Overall Fund Structure and Objectives

CAAERS was established to provide retirement, disability, and death benefits to general, police, and firefighter retirees and their beneficiaries. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

It is the responsibility of the CAAERS Board to determine the allocation of assets among distinct capital markets in accordance with allowable legal limits. Based on an asset allocation review conducted in 2007, which analyzed the expected returns of various asset classes, the Plan's actuarial assumption rate, and the risks associated with alternative asset mix strategies, the Board has established the following asset allocation:

<u>Asset Class</u>	<u>Target</u>	<u>Range</u>
Large Capitalization Domestic Equity	25%	+/- 5%
Mid Capitalization Domestic Equity	18%	+/- 5%
Small Capitalization Domestic Equity	12%	+/- 5%
International Equity	10%	+/- 3%
Bonds	22%	+/- 3%
Real Estate	10%	- 3%
Stable Value	3%	+/- 1%

The study has shown that this asset mix offers the optimal mix for meeting longer term goals. The asset classes stated above shall be further diversified (where possible) as to style and manager type to reduce risk further, while providing the opportunity for enhanced return.

Economic Factors, Investment Returns, and Other Important Matters

In 2006/07 the collapse of the housing market weighed on the economy and the possibility of a recession in the future has increased. The deterioration of the sub-prime market manifested in the collapse of high profile hedge funds and structured investment vehicles. The magnitude of the credit crisis and its repercussions across the capital markets is still unknown. The weaker dollar has caused oil prices in the U.S. to rise faster than in countries with appreciating currencies. The U.S. faces inflationary pressure due to higher energy costs, a possible weakening economy associated with the falling housing market, additional depreciation of the dollar, and further sub-prime market fall out.

Because the stock market is the principal investment forum utilized by CAAERS, the market's 2006/07 market rate of return had a positive impact on net assets. In 2005/06, the value of CAAERS net assets held in trust for pension benefits increased by 3.9 percent. In 2006/07 net assets held in trust increased by 11.57%. It is important to note that CAAERS' purpose is to provide long-term benefit payments to its members and it is through long-term investing, as shown by the current year increase, that these promised benefits will be primarily funded. Through its investment policy asset allocation, the Board has positioned the portfolio for this long-term investment objective. In addition, to further maximize investment returns, management carefully monitors the performance of each of its investment managers and takes the necessary corrective action to ensure acceptable investment results.

Since CAAERS receives all of its new funding from its plan sponsor, the City of Ann Arbor's annual contribution is critical for the System's long-term viability. The City annually ensures that this actuarially computed amount is paid into CAAERS.

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2007 and 2006

Contacting the System's Financial Management

This financial report is designed to provide the public, citizens, and other interested parties with a general overview of CAAERS' finances and to show accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City of Ann Arbor Employees' Retirement System administrative offices at 301 East Liberty Street, Suite 680, Ann Arbor, Michigan 48104. The telephone number is (734) 994-4590.

City of Ann Arbor
Employees' Retirement System

STATEMENT OF PLAN NET ASSETS

June 30, 2007 and 2006

(amounts expressed in thousands)

	<u>2007</u>	<u>2006</u>
ASSETS		
Cash	\$ 243	\$ 1,285
Receivables		
Interest and dividends	876	773
Due from other funds of the City of Ann Arbor	<u>791</u>	<u>345</u>
Total receivables	1,667	1,118
Investments, at fair value		
Short term investments	4,341	6,273
U. S. government obligations	47,468	36,244
Municipal bonds	1,003	-
Collateralized mortgage obligations	8,682	14,968
Guaranteed investment contracts	12,932	12,420
Domestic and foreign corporate bonds	37,221	29,891
Domestic and foreign stocks	290,766	258,344
Real estate - direct and funds	<u>48,372</u>	<u>45,076</u>
Total investments	450,785	403,216
Capital assets at cost, net of accumulated depreciation of \$26 and \$25, respectively	<u>3</u>	<u>3</u>
Total assets	452,698	405,622
LIABILITIES		
Refunds payable and other	<u>2,782</u>	<u>2,351</u>
NET ASSETS		
Held in trust for pension benefits	<u>\$ 449,916</u>	<u>\$ 403,271</u>

See accompanying notes to financial statements

City of Ann Arbor
Employees' Retirement System

STATEMENT OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2007 and 2006

(amounts expressed in thousands)

	<u>2007</u>	<u>2006</u>
ADDITIONS TO NET ASSETS		
Investment income		
Net appreciation in fair value of investments	\$ 59,910	\$ 29,948
Interest	5,111	10,131
Dividends	<u>1,791</u>	<u>1,770</u>
Total investment income	66,812	41,849
Less: investment expense	<u>(1,802)</u>	<u>(1,759)</u>
Net investment income	<u>65,010</u>	<u>40,090</u>
Contributions		
Employer	5,103	2,898
Plan members	<u>2,653</u>	<u>2,950</u>
Total contributions	<u>7,756</u>	<u>5,848</u>
Total additions to net assets	72,766	45,938
DEDUCTIONS FROM NET ASSETS		
Benefits	24,505	22,567
Refunds of contributions	1,024	611
Administrative expense	<u>592</u>	<u>7,509</u>
Total deductions from net assets	<u>26,121</u>	<u>30,687</u>
CHANGE IN PLAN NET ASSETS	46,645	15,251
Net assets - beginning of year	<u>403,271</u>	<u>388,020</u>
Net assets - end of year	<u><u>\$ 449,916</u></u>	<u><u>\$ 403,271</u></u>

See accompanying notes to financial statements

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2007 and 2006

NOTE A: DESCRIPTION OF SYSTEM AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Ann Arbor Employees' Retirement System (CAAERS) is a single-employer defined benefit plan established and administered by the City of Ann Arbor to provide retirement, disability and death benefits to general, police and firefighter employees and their beneficiaries. Cost of living adjustments are provided to members and beneficiaries per the Ann Arbor City Code Section 1:573 of Chapter 18. Chapter 17.1 of the Ann Arbor City Charter assigns the authority to establish and amend benefit provisions to City Council.

All plan members are required to contribute 5% of annual compensation. The City is required to contribute at an actuarially determined rate; the current rate is 9.96% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Ann Arbor City Council. Administrative costs of CAAERS are financed through investment earnings.

The System's more significant accounting policies are described below.

Reporting entity. The accompanying financial statements are exclusive presentations of the financial condition and results of operations of the City of Ann Arbor Employees' Retirement System. The City of Ann Arbor is the plan sponsor of CAAERS. As a result, industry standards require the City to include the financial activities of the System in the City's Annual Financial Report. The Annual Financial Report of the City of Ann Arbor is available for public inspection at the Ann Arbor City Hall.

Basis of Accounting. CAAERS' financial statements are prepared using the accrual basis of accounting. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments. Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value.

NOTE B: PLAN DESCRIPTION AND CONTRIBUTION INFORMATION

Membership of the plan consisted of the following at June 30, 2007, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	820
Terminated plan members entitled to, but not yet receiving, benefits	117
Active plan members	<u>801</u>
Total	<u><u>1,738</u></u>
Number of participating employers	1

NOTE C: DEPOSITS AND INVESTMENTS

Deposits

The System does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash and cash equivalents in the statement of plan net assets are composed entirely of short-term investments in money market accounts.

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2007 and 2006

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Investments

The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the System to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The System's Board has the responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to assist in managing the System's assets. All investment decisions are subject to Michigan law and the investment policy established by the Board.

The System has investments, which are held by an independent trust company. Following is a summary of the System's investments as of June 30, 2007 and 2006:

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Short-term investments	\$ 4,341,340	\$ 6,272,826
U.S. government obligations	47,468,204	36,243,383
Municipal bonds	1,002,522	-
Collateralized mortgage obligations	8,682,104	14,967,711
Guaranteed investment contracts	12,932,089	12,420,020
Domestic and foreign corporate bonds	37,221,116	29,891,136
Domestic and foreign stocks	290,765,832	258,344,207
Real estate - direct & funds	<u>48,372,241</u>	<u>45,076,473</u>
Total Investments	<u>\$ 450,785,448</u>	<u>\$ 403,215,756</u>

Custodial Credit Risk

For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy requires that investment securities be held in trust by a third-party institution in the System's name. As such, although uninsured and unregistered, the System's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the System's name. Short-term investments in money market funds are not subject to custodial credit risk.

Credit Risk

The System's investment policy provides that its investments in fixed income securities be limited to those rated investment grade by a nationally recognized statistical rating organization. As of June 30, 2007, the System's investments in securities of U.S. agencies were all rated AAA by Standard & Poor's. The System's investments in corporate securities were rated by Standard & Poor's as follows:

Pension Investments

AAA	\$ 1,738,010
AA	1,144,121
A	6,581,024
BBB	6,658,965
BB	903,835
B	747,564
Not rated	<u>19,447,597</u>
	<u>\$ 37,221,116</u>

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2007 and 2006

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Concentration of Credit Risk

The System's investment policy requires that the securities of any one company or government agency should not exceed 5% of the total fund. At June 30, 2007 the System's investments were within that range.

Interest Rate Risk

For investments, the risk that changes in interest rates will adversely affect the fair value of the investment is known as interest rate risk. The System's investment policy provides for securities with terms to maturity of up to 30 years. As of June 30, 2007, maturities of the System's debt securities were as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
U.S. treasuries	\$ 22,598,035	1.68
U.S. agencies	24,870,169	6.46
Municipal bonds	1,002,522	0.08
Corporate bonds	37,221,116	3.55
Domestic Corporate securities	<u>8,682,104</u>	3.59
Total debt securities	<u>\$ 94,373,946</u>	
Portfolio weighted average maturity		15.36

NOTE D: ADMINISTRATIVE AND INVESTMENT EXPENSES

The following provides additional details related to administrative and investment expenses for the year ended June 30, 2007.

Administrative expenses

Salary	\$ 249,245
Office rent	56,859
Conferences and training	49,451
Information Technology Services	45,013
Other	<u>191,443</u>
	<u>\$ 592,011</u>

Investment expenses

Oppenheimer	\$ 359,446
Independence	325,529
Loomis, Sayles & Co., Inc.	199,423
Bradford & Marzec, Inc.	144,317
Other investment managers	<u>772,950</u>
	<u>\$ 1,801,665</u>

REQUIRED SUPPLEMENTARY INFORMATION

City of Ann Arbor
Employees' Retirement System

SCHEDULE OF FUNDING PROGRESS

(amounts expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
6/30/2007	\$413,712	\$413,490	\$(222)	100.1	\$50,678	0.4%
6/30/2006	398,258	407,302	9,044	97.8%	49,627	18.2%
6/30/2005	398,690	384,369	(14,321)	103.7%	47,225	-30.3%
6/30/2004	409,324	370,409	(38,915)	110.5%	47,109	-82.6%
6/30/2003	417,623	353,620	(64,003)	118.1%	46,213	-138.5%
6/30/2002	426,440	336,340	(90,100)	126.8%	46,744	-192.8%

City of Ann Arbor
Employees' Retirement System

SCHEDULE OF EMPLOYER CONTRIBUTIONS

(amounts expressed in thousands)

Year Ended June 30	Annual Required Contribution	Percentage Contribution
2007	\$ 5,039	100.0%
2006	2,871	100.0%
2005	1,045	100.0%
2004	-	100.0%
2003	-	100.0%
2002	-	100.0%

Principals

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF THE FINANCIAL STATEMENTS**

To the Members of the Audit Committee
City of Ann Arbor Employees' Retirement System
Ann Arbor, Michigan

We have audited the financial statements of the City of Ann Arbor Employees' Retirement System for the year ended June 30, 2007, and have issued our report thereon dated December 20, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Ann Arbor Employees' Retirement System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Ann Arbor Employees' Retirement System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Ann Arbor Employees' Retirement System's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal controls.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that might be significant material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Ann Arbor Employees' Retirement System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instance of noncompliance or other matters.

This report is intended solely for the information and use of the Audit Committee and management of the City of Ann Arbor Employees' Retirement System and is not intended to be and should not be used by anyone other than these specified parties.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

December 20, 2007